Siddhartha Bank Limited

ICRA Nepal assigns [ICRANP] LA- to proposed subordinated debenture programme of Siddhartha Bank; upgrades outstanding ratings to [ICRANP] LA- and [ICRANP-IR] A-

Facility/Instrument	Amount	Rating Action (May 2019)
Subordinated Debenture Programme	NPR 2,500 million	[ICRANP] LA- (assigned)
Subordinated Debenture Programme	NPR 2,162.56 million[1]	[ICRANP] LA- (upgraded)
Issuer Rating	NA	[ICRANP-IR] A- (upgraded)
Subordinated Debenture Programme	NPR 500 million	[ICRANP] LA- (upgraded)

ICRA Nepal has assigned a rating of **[ICRANP] LA-** (pronounced ICRA NP long-term debt rating A minus) to the proposed subordinated[2] debenture programme worth NPR 2,500 million of Siddhartha Bank Limited (SBL). A subordinated debenture rating of A- is one notch lower than A. Instruments with this rating are considered to have an adequate degree of safety regarding the timely servicing of the financial obligations. Such instruments carry low credit risk. ICRA Nepal has also upgraded SBL's outstanding debenture rating to **[ICRANP] LA-** (pronounced ICRA NP long-term debt rating A minus) from **[ICRANP] LBBB+** (pronounced ICRA NP long-term debt rating triple B plus).

ICRA Nepal has upgraded the outstanding issuer rating of SBL to **[ICRANP-IR] A-** (pronounced ICRA NP issuer rating A minus) from **[ICRANP-IR] BBB+** (pronounced ICRA NP issuer rating triple B plus)**.** Issuers with this rating are considered to have an adequate degree of safety regarding the timely servicing of the financial obligations. Such issuers carry low credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument.

The assigned and upgraded ratings factor in SBL's steady financial indicators including its good asset quality in recent years, notwithstanding the marginal deterioration in 9M FY2019. The rating action also factors in SBL's increasing footprint across the country, which has helped the bank maintain good growth as well as geographical diversification and portfolio granularity. Although the bank's high credit growth raises concerns about the incremental asset quality amid high interest rates and tight liquidity in the banking sector, the same is partly mitigated by the low concentration of credit among the top borrowers. Accordingly, SBL's ability to withstand credit shocks and maintain its solvency profile remains adequate despite its moderate capitalisation profile. This has been factored into the rating action. The ratings also derive comfort from the bank's adequate track record (operating since 2002), promoters with sufficient financial sector experience, and the stable and experienced senior management team. The ratings also factor in SBL's good profitability profile, supported by healthy net interest margins (NIMs) and adequate non-interest income levels.

The ratings are, however, constrained by SBL's relatively inferior deposit profile vis-à-vis the commercial bank average (CASA[3] deposits of ~37% as of mid-April 2019 vs. ~41% for the commercial bank industry). This stems from the bank's higher reliance on institutional deposits over the years to fund its high credit growth. SBL's low CASA proportion and resultant higher cost of deposits (7.69% in 9M FY2019, ~120 bps above the commercial bank average) could be a competitive disadvantage in the 'base rate plus' lending model practised in the industry.

SBL's concentration of deposits among the top accounts remains on the higher side and stays a rating concern, especially in the backdrop of tight liquidity and increasing volatility in interest rates. This could expose the bank to liquidity shocks. Although SBL's incremental CASA proportion and cost of funds are expected to benefit from the growth in its franchise network and concomitantly higher penetration among retail depositors, the bank's ability to improve the deposit mix and cost remains to be seen. The ratings

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[1] *Of NPR 2,250 million of debentures floated, SBL received subscriptions for ~NPR 2,162 million (~96% of the issue size)*

[2] *Subordinated to deposits for principal repayment, in the event of liquidation. Subordinated debentures are eligible for inclusion in the calculation of tier II capital*

[3] *Current and savings accounts*

are also constrained by SBL's moderate capitalisation profile vis-à-vis its peers (CRAR of 12.37% and tier I capital of 9.71% vs. the regulatory minimum requirement of 11% and 8.5% under Basel III norms).

SBL's asset quality and liquidity profile will be key monitorable, given the high credit growth registered by the bank in recent years and the prevailing high interest rates as well as the shortage of lendable funds and the deposit rate volatility in the market. Although the bank's credit portfolio granularity partly offsets the probable risks arising from credit shocks, its relatively higher exposure to sectors that are vulnerable to upticks in interest rates (viz. real estate, hire purchase, etc) remains a concern. The liquidity profile could also come under pressure due to the lower growth in deposits vis-à-vis credit, the high CCD ratio maintained by the bank, its high reliance on call deposits (albeit with moderation in recent periods) and the interest rate volatility in the banking industry.

During 9M FY2019, SBL's credit portfolio registered annualised growth of ~29% vs. ~28% growth in FY2018, both above the commercial bank average. The growth was partly aided by an increase in the bank's branch network (146 as of mid-April 2019 and 118 in mid-July 2018 from 70 in mid-July 2017). As of mid-July 2018, SBL's credit portfolio primarily comprised corporate loans (~63%), retail loans (28%) and SME loans (9%)[4]. Going forward, with increased penetration and access to a larger customer base (due to expansion of the branch network), SBL's SME/retail segment is likely to get a further boost. The concentration of the top borrower groups remains on the lower side, which is a comfort. As of mid-April 2019, SBL's top 20 borrower groups accounted for ~12% of the total loans (compared to 13% when last rated). However, SBL's exposure to relatively vulnerable sectors[5] remained higher as of mid-April 2019 (~19% vs. commercial bank average of ~13%) despite a recent decline (~22% exposure to vulnerable sectors when last rated).

In terms of asset quality, SBL reported an improvement in its gross NPA levels over the years. The gross NPA level declined to 1.05% in mid-July 2018 and 1.30% in mid-July 2017 from 1.47% in mid-July 2016, partly aided by the credit growth during the interim period. However, there was an uptick in the NPA and delinquency levels in 9M FY2019 with gross NPAs rising to 1.36% and 0+ days delinquency rising to ~4% from ~2.5% in mid-July 2018. Nonetheless, SBL's gross NPA level remains well under the commercial bank average and the spike in 9M FY2019 can be expected to moderate at the end of Q4 FY2019. Due to the low NPA levels, SBL has been able to maintain a good solvency profile (net NPA/net worth of ~5%) despite the recent increase in the NPA levels and the low NPA provision cover (~51% as of mid-April 2019).

SBL's CASA deposits, as of mid-April 2019, declined to 37% (vs. the commercial bank average of 41%) from ~40% in mid-July 2018. The bank's CASA share has come under pressure since FY2017 because of the deposit crunch in the banking industry and the high rate of conversion to term deposits from CASA owing to the high price differentials. Lower CASA vis-à-vis the industry average translates into higher cost of funds for SBL, which limits its competitive positioning in the 'base rate plus' lending model practised in the industry. As of mid-April 2019, SBL's deposit portfolio of NPR 105 billion comprised term deposits (50%), CASA deposits (37%) and call deposits (13%). The bank's reliance on call deposits remains on the higher side despite a recent decline. However, with the growth in its branch network and customer base, the bank's retail deposit base is expected to improve with a concomitant improvement in the CASA proportion and deposit granularity. The bank's deposit concentration remains on the relatively higher side despite improvement over the years. As of mid-April 2019, SBL's top 20 depositors accounted for ~27% of the total deposits. The bank's ability to improve the deposit granularity and lower the concentration risk remains to be seen.

SBL's profitability remains supported by the steady NIMs of ~3.3-3.5% maintained during the past two to three years. The bank has been able to maintain a healthy yield on its advances, partly aided by portfolio granularity and exposure to high-yield segments like real estate and hire purchase. The higher yield has supported the bank's NIMs despite the relatively higher cost of deposits. The NIMs also remain

[4] Loans up to NPR 40 million towards single borrower group is classified as SME and beyond that corporate loans
[5] Includes real estate, hire purchase, mining and margin loans

supported by SBL's healthy rate of credit mobilisation (CCD[6] ratio of ~79% in mid-April 2019). SBL's non-interest income remained adequate at ~1.08% of average total assets (ATA) over the last one to two years, supporting its profitability profile. The credit cost also remains on the lower side due to the good asset quality, notwithstanding a recent deterioration. However, SBL's operating expense has increased in recent periods (2.01% of ATA in 9M FY2019 from 1.63% of ATA in FY2018) amid an increase in the branch network and associated costs, affecting the profitability profile. This, however, can be expected to moderate, going forward, as the new branches achieve full efficiency and generate economies of scale. Due to an increase in the operating expense ratio in 9M FY2019, SBL's return on assets (RoA) moderated to ~1.5% of ATA from ~1.8% of ATA in FY2018 with a concomitant decline in the return on net worth (RoNW) to ~14% from ~16%. The incremental profitability outlook of SBL is likely to be determined by its asset quality, quality and cost of deposits and operational efficiencies.

As of mid-April 2019, SBL's capital to risk assets ratio (CRAR) stood at 12.37% (vs. 12.10% as of mid-July 2018). While this was adequate vis-à-vis the regulatory minimum of 11% under the prevailing Basel III norms, it was moderate compared to peers. SBL's CRAR has improved in recent years (12%+ in FY2017 and FY2018 vs. 11%+ in the previous two years), thereby marginally improving the bank's ability to withstand credit shocks. SBL's tier I capital of 9.71%, as of mid-April 2019 (10.99% as on mid-July 2018), though moderate among peers, remained adequate vis-à-vis 8.50% to be maintained by mid-July 2019 under the Basel III norms prescribed by the Nepal Rastra Bank (NRB). SBL's current capitalisation ratio remains supported by the recent debenture issuance and is likely to be further strengthened after the issuance of the proposed tier II debentures, assuming full subscription. Accordingly, the capitalisation levels are expected to remain adequate to support SBL's growth plans over the next 1-2 years. The bank's adequate profitability level is also expected to support its capital requirement for future growth. The timely raising of capital (including equity capital) to maintain capital cushions of ~1-2% above the regulatory levels while achieving growth will remain a key rating sensitivity. In case the capital cushions remain weak on a sustained basis, the same will be a credit negative.

Links to applicable criteria:

Corporate Credit Rating Methodology

Bank Rating Methodology

Bank Profile

Siddhartha Bank Limited (SBL), the 18th Class A Commercial Bank to be licensed by the NRB, commenced operations in December 2002. As of mid-April 2018, SBL had a market share of ~3.5% in terms of deposit base and total advances in the Nepalese banking industry (~4.2% in the commercial bank industry's deposits and advances). As of mid-April 2019, SBL had a presence across the country through 146 branches.

As of mid-April 2019, SBL's shareholding was divided among the promoters and public shareholders in the ratio of 51:49. The bank is promoted by individuals and private institutions related to different business houses of Nepal, mainly the Kedia Group.

SBL reported a profit after tax of NPR 1,904 million[7] in FY2018 on an asset base of NPR 119,866 million vis-à-vis a profit after tax of NPR 1,386 million in FY2017 on an asset base of NPR 89,902 million as of mid-July 2017. As of mid-April 2019, SBL's CRAR was 12.37% (tier I capital of 9.71%) and gross NPA was 1.36%. On the technology front, SBL uses the Flex-Cube banking software for its day-to-day operations and the software is linked to a management information system.

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For further details please contact:

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[6] *Credit to deposit ratio adjusted for capital (net worth)*

[7] *Audited as per Nepal Financial Reporting Standard (NFRS); financial reporting from FY2018 is under NFRS*

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About ICRA Nepal Limited

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